



Auditing to build public confidence

**AUDITOR-GENERAL
SOUTH AFRICA**

OR Tambo District Municipality

Audit Report

For the year ended 30 June 2017

Report of the auditor-general to Eastern Cape Provincial Legislature and the council on the O.R. Tambo District Municipality

Report on the audit of the consolidated and separate financial statements

Qualified opinion

1. I have audited the consolidated and separate financial statements of the O.R. Tambo District Municipality set out on pages ... to ... , which comprise the statement of financial position as at 30 June 2017, and the statement of financial performance, statement of changes in net assets and cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes to the consolidated and separate financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the O.R Tambo District Municipality as at 30 June 2017, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2016 (Act No. 3 of 2016) (DoRA).

Basis for qualified opinion

Irregular expenditure

3. The municipality did not disclose all its irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 57 to the consolidated and separate financial statements was materially understated in respect of amounts incurred during the year that were identified during the audit process. I was unable to determine the full extent of the misstatement for the disclosed amount of R679,9 million in note 57.

Context for the opinion

4. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the consolidated and separate financial statements section of this report.
5. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Emphasis of matters

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

8. As disclosed in note 48 to the consolidated and separate financial statements, the corresponding figures for 30 June 2016 have been restated as a result of errors discovered during the year ended 30 June 2017 in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2016.

Unauthorised expenditure

9. As disclosed in note 55 to the consolidated and separate financial statements, unauthorised expenditure amounting to R1 million (2015-16: R18,3 million) was incurred by the municipality during the year. In addition the municipality accumulated a balance of R2,3 billion which was written off during the 2016-17 financial year. This resulted in a closing balance of R1 million (2015-2016: R2,3 billion) at the end of the 2016-17 financial year which has not been investigated by the council.

Irregular expenditure

10. As disclosed in note 57 to the consolidated and separate financial statements the municipality accumulated an irregular expenditure balance of R4,3 billion, of which R2,1 billion was written off during the 2016-17 financial year. This resulted in a closing balance of R2,8 billion (2015-2016: R4,3 billion) at the end of the 2016-17 financial year which has not been investigated by the council.

Fruitless and wasteful expenditure

11. As disclosed in note 56 to the consolidated and separate financial statements, fruitless and wasteful expenditure of R5,9 million (2015-2016: R0,5 million) was incurred by the municipality during the year. In addition the municipality accumulated a R21,6 million (2015-2016: R24,2 million balance at the end of the 2016-17 financial year which has not been investigated by council.

Impairment loss

12. As disclosed in the consolidated and separate financial statements material debt impairments of R141,4 million (2015-16: R88,7 million) on receivables from exchange and non-exchange transactions was disclosed in note 34 to the consolidated and separate financial statements. This arose from the poor expected recoverability of trade debtors.

Material losses

13. As disclosed in note 60 to the consolidated and separate financial statements, material losses of R22,8 million (2015-16: R12,8 million) was incurred as a result of water losses.

Other matters

14. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

15. In terms of section 125(2)(e) of the MFMA, the entity is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Responsibilities of the accounting officer for the consolidated and separate financial statements

16. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the SA standards of GRAP and the requirements of the MFMA and DoRA and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
17. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the intention is to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the consolidated and separate financial statements

18. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated and separate financial statements.
19. A further description of my responsibilities for the audit of the consolidated and separate financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

20. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
21. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators/measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

22. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following development priorities presented in the annual performance report of the municipality for the year ended 30 June 2017:

Development priorities	Pages in the annual performance report
Development priority – <i>key performance area</i> (KPA 1): basic service delivery and infrastructure	x – x
Development priority – KPA 2: local economic development	x – x

23. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
24. The material findings in respect of the usefulness and reliability of the selected development priorities are as follows:

KPA 1: Basic service delivery and infrastructure

Usefulness

Indicator not consistent

BSDI-3.number of housing units for Adam Kok farm workers constructed

25. The indicator was reported as number of housing units for Adam Kok farm workers constructed, while the indicator was approved as percentage completion of the planning phases for the construction of Adam Kok housing units in the adjusted service delivery and budget implementation plan (SDBIP). This is not in line with the requirements of section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000)(Municipal Systems Act).

Indicators not verifiable

26. I was unable to obtain sufficient appropriate audit evidence to validate the existence of systems and processes that enable reliable reporting of actual service delivery against the indicators detailed in the table below, as required by the Framework for managing programme performance information. This was due to a lack of adequate technical indicator descriptions and/or formal standard operating procedures or documented system descriptions. Furthermore there was a lack of adequate supporting documentation to substantiate systems and processes. I was unable to validate the existence of systems and processes by alternative means.

Performance indicator	Reported achievement
BSDI-6. number of initiation schools supported	9
BSDI-33.number of households receiving social safety support (distress support, child protection etc.)	2027
BSDI-41.percentage completion of phase 4 &5 for Coffee Bay Regional Water Supply Scheme(RWSS)	83%
BSDI-42.percentage completion of Mqanduli Corridor Bulk Water Supply Scheme (WSS)	88%
BSDI-44.percentage completion of Flagstaff Phase 3 regional Water Supply Scheme (RWSS)	90%
BSDI-45. number of stand-alone schemes refurbished	4
BSDI-47.number of indigent households supplied with tanks and gutter for rainwater harvesting	100
BSDI-50.number of indigent households receiving free basic water & Sanitation Services	153 000
BSDI-51.blue drop status compliance	46%
BSDI-54.percentage completion of bulk sewer projects - Mqanduli	92%
BSDI-62.green drop status compliance	26%
BSDI-63.number of non-functional schemes refurbished	54

Reliability

BSDI-33.number of households receiving social safety support (distress support, child protection etc.)

27. The systems and processes implemented by the municipality to ensure accurate reporting of its actual performance against all of the planned indicators and targets of KPA 1: basic service delivery and infrastructure was not effective. The reported achievement for target of 19 500 was misstated as the evidence provided indicated 2790 and not 2027 as reported.

Limitation of scope – various indicators

28. I was unable to obtain sufficient appropriate audit evidence for 26 out of the 37 indicators relating to KPA 1: basic service delivery and infrastructure. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements of the following indicators:

Performance indicator	Reported achievement
BSDI-2. number of housing units for destitute and vulnerable groups constructed	5
BSDI-6. number of initiation schools supported	9
BSDI-14. percentage of households supported in disaster affected areas	100%
BSDI-21. percentage of fire and emergency incidents responded to within 30 minutes for areas within a 50 kilometres radius	100%
BSDI-22. percentage of fire and emergency incidents responded to within 1 hour 45 minutes for areas more than 50 kilometres radius	100%
BSDI-39. percentage completion of Ngangelizwe Breaking New Ground (BNG) Bulk sewer and water system	80%
BSDI-40. percentage completion of pipeline to Langeni Housing Development	5%
BSDI-41. percentage completion of phase 4 & 5 for Coffee Bay Regional Water Supply Scheme (RWSS)	83%
BSDI-42. percentage completion of Mqanduli Corridor Bulk Water Supply Scheme (WSS)	88%
BSDI-43. percentage completion of Libode and Ngqeleni Corridor Bulk Water Supply Scheme (WSS)	48%
BSDI-44. percentage completion of Flagstaff Phase 3 regional Water Supply Scheme (RWSS)	90%
BSDI-45. number of stand-alone schemes refurbished	4
BSDI-46. number of water works refurbished	14

Performance indicator	Reported achievement
BSDI-47. number of indigent households supplied with tanks and gutter for rainwater harvesting	100
BSDI-49.number of purified mega litres of water carted and delivered to communities.	189
BSDI-50.number of indigent households receiving free basic water & sanitation services	153 000
BSDI-51.blue drop status compliance	46%
BSDI-52.number of Ventilated Improved Pit (VIP) toilets provided	9 216
BSDI-54.percentage completion of bulk sewer projects - Mqanduli	92%
BSDI-55.percentage completion of bulk sewer projects - Port St Johns (PSJ)	10%
BSDI-56.percentage completion of bulk sewer projects – Lusikisiki	96%
BSDI-57.percentage completion of bulk sewer projects – Flagstaff	40%
BSDI-58.percentage completion of bulk sewer projects –Qumbu	5%
BSDI-59.percentage completion of bulk sewer projects –Libode	10%
BSDI-62.green drop status compliance	26%
BSDI-63.number of non-functional schemes refurbished	54

KPA 2: Local economic development

Reliability

29. I was unable to obtain sufficient appropriate audit evidence for two out of the 11 indicators relating to this programme. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievements by alternative means.

Consequently, I was unable to determine whether any adjustments were required to the reported achievements of the following indicators:

Performance indicator	Reported achievement
LED-4. number of small medium micro enterprises (SMME's) capacitated	88
LED-7. number of aquaculture enterprises trained	32

Other matters

30. I draw attention to the matters below.

Achievement of planned targets

31. Refer to the annual performance report on page(s) x to x; x to x for information on the achievement of planned targets for the year and explanations provided for the under / overachievement of a significant number of targets. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs x; x; x of this report.

Report on audit of compliance with legislation

Introduction and scope

32. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

33. The material findings on compliance with specific matters in key legislations are as follows:

Strategic planning and performance management

34. The performance management system and related controls were not maintained or were inadequate as they did not describe how the performance planning, monitoring, measurement, review, reporting and improvement processes should be conducted, organised and managed, as required by municipal planning and performance management regulation 7(1).

Budgets

35. Reasonable steps were not taken to prevent unauthorised expenditure of R 1,0 million, as disclosed in note 51 to the annual consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA.

Annual financial statements, performance and annual report

36. The consolidated and separate financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of

the MFMA. Material misstatements of current assets, liabilities, expenditure and disclosure items identified by the auditors in the submitted consolidated and separate financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the consolidated and separate financial statements receiving a qualified audit opinion.

Expenditure management

- 37. Effective steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred.
- 38. Effective steps were not taken to prevent fruitless and wasteful expenditure of R5,9 million, as disclosed in note 53 to the consolidated and separate annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed irregular expenditure was caused by legal and interest costs.
- 39. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

Consequence management

- 40. Irregular and fruitless and wasteful expenditure was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a) and b of the MFMA.

Procurement and contract management

- 41. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of supply chain management(SCM) regulation 17(a) and (c). Similar non-compliance was also reported in the previous year.
- 42. Quotations were accepted from bidders who did not submit a declaration on whether they were employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
- 43. Quotations were accepted from bidders whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.
- 44. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
- 45. Some of the invitations for competitive bidding were not advertised for a required minimum period of days, in contravention of SCM regulation 22(1) and 22(2). Similar non-compliance was also reported in the previous year.
- 46. Some of the competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2).

47. Some of the contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.
48. The preference point system was not applied on some of the procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 200). Similar non-compliance was also reported in the previous year.
49. Commodities designated for local content and production, were procured from suppliers who did not submit a declaration on local production and content as required by Preferential Procurement Regulation 9(1).
50. Bid documentation for procurement of commodities designated for local content and production, did not stipulate the minimum threshold for local production and content as required by Preferential Procurement Regulation 9(1).
51. Commodities designated for local content and production, were procured from suppliers who did not meet the prescribed minimum threshold for local production and content, as required by Preferential Procurement Regulation 9(5).
52. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the previous year.
53. Awards were made to providers who were in the service of other state institutions or whose directors were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).

Human resource management

54. Appropriate systems and procedures to monitor, measure and evaluate performance of staff were not developed and adopted as required by section 67(1)(d) of the MSA.

Conditional grants

55. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant, as required by section 12(5) of the DoRA. The municipality did not evaluate its performance in respect of programmes or functions funded by the Regional Bulk Infrastructure Grant, as required by section 12(5) of the DoRA.

Other information

56. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the consolidated and separate financial statements, the auditor's report and

those selected development priorities presented in the annual performance report that have been specifically reported in the auditor's report.

57. My opinion on the consolidated and separate financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
58. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
59. If based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Internal control deficiencies

60. I considered internal control relevant to my audit of the consolidated and separate financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
- The leadership did not establish a compliance and performance culture within the municipality. This is further substantiated by the fact that no officials have been held accountable for past unauthorised, irregular and fruitless and wasteful expenditure incurred as confirmed by the work performed by the section 32 committee established by the council. Officials continued to disregard legislation governing procurement and SCM and the leadership did not respond with appropriate consequence management steps against these officials through formal investigations. Consequently a significant portion of irregular expenditure was again detected during the audit process. The leadership adopted a reactive approach to irregular expenditure that focused on the identification and reporting of irregular expenditure after it was incurred instead of focusing on the prevention of it. Leadership's inability to address and prioritise this critical area had a direct bearing on the number of compliance findings raised.
 - The municipality did not have sufficient monitoring controls to ensure the proper implementation of the overall process of planning, budgeting, implementation and reporting within the annual financial statements and annual performance report as well as compliance with legislation.
 - The institution did not have adequate action plans in place to address shortcomings in irregular expenditure, compliance and performance management that were identified during internal and external review processes.

- Systems and processes were not in place to monitor compliance with applicable legislation. This is a repeat finding. Resources available at the municipality were focused on addressing deficiencies in the annual financial statements; however, this focus did not extend to the compliance deficiencies.
- Management did not respond to all the recommendations of the audit committee and internal audit unit which affected the effectiveness of these governance structures and resulted in repeat audit findings being raised.

AUDITOR - GENERAL

East London

20 December 2017



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general's responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the separate financial statements, and the procedures performed on reported performance information for selected key performance areas and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the consolidated and separate financial statements as described in the auditor's report, I also:
 - identify and assess the risks of material misstatement of the consolidated and separate financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control.
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
 - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the consolidated and separate financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the O.R. Tambo District Municipality ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the consolidated and separate financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the separate financial statements. My conclusions are based on the information available to me at the date of the auditor's report. However, future events or conditions may cause a municipality to cease to continuing as a going concern.
 - evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
 - obtain sufficient appropriate audit evidence regarding the financial information of the entity or business activities within the group to express an opinion on the consolidated financial statements. I am responsible for the direction, supervision and performance of the group audit. I remain solely responsible for my audit opinion.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.

